Supreme Court, U.S.
FILED
FEB 23 1994
OFFICE OF THE CLERK

(3)

No. 93-1132

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

REUTERS LIMITED,

Petitioner,

- vs. -

TAX APPEALS TRIBUNAL and
COMMISSIONER OF TAXATION AND FINANCE,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE
COURT OF APPEALS OF THE STATE OF NEW YORK

REPLY BRIEF FOR PETITIONER

STEVEN ALAN REISS
Counsel of Record
PHILIP T. KAPLAN
DAVID B. GOLDSTEIN
WEIL, GOTSHAL & MANGES
767 Fifth Avenue
New York, New York 10153
(212) 310-8000

STUART H. SIMON
REUTERS AMERICA, INC.
1700 Broadway
New York, New York 10019
(212) 603-3300
Attorneys for Petitioner Reuters Limited

Dated: February 23, 1994

PRINTINGHOUSE PRESS
25 West 43rd Street New York, New York 10036 (212) 719-0990

TABLE OF CONTENTS

Page

REASONS FOR GRANTING THE PETITION 2

I. THE DECISION BELOW IS CONTRARY TO THE TREATY'S LANGUAGE, ITS INTERPRETATION BY THE PARTIES, AND THE INTERPRETATION OF IDENTICAL TREATY LANGUAGE 2

II. THE EXTRAORDINARY TAX COMPLIANCE BURDEN DISCRIMINATES AGAINST REUTERS IN VIOLATION OF THE TREATY AND THE FOREIGN COMMERCE CLAUSE 8

III. THE NEW YORK FRANCHISE TAX REGULATIONS FACIALLY DISCRIMINATE AGAINST FOREIGN SOURCE INCOME IN VIOLATION OF THE FOREIGN COMMERCE CLAUSE 9

CONCLUSION 10

TABLE OF AUTHORITIES

CASES: **Page(s)**

Barclays Bank PLC v. *Franchise Tax Bd., pet. for cert. granted*, 114 S.Ct. 379 (1993) 9

Judgment of March 30, 1973, Finanzgerichte in Dusseldorf, 10 Entscheidungen der Finanzgerichte [EFG] 509 (F.R.G.) . 7

Judgment of November 18, 1985, Conseil D'Etat (Fr.) 6

Kraft General Foods, Inc. v. *Iowa Dep't of Revenue and Finance*, 112 S.Ct. 2365 (1992) 4, 9, 10

New Haven Inclusion Cases, 399 U.S. 392 (1970) 8

OTHER:

Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, December 31, 1975 U.S.-U.K., 31 U.S.T. 5666 2

Art. 7(2) 5

Art. 24(2) . . . . . passim

I.R.S. Notice 89-80, 1989-2 C.B. 394 6

Third Protocol to the 1975 Income Tax Convention, as Amended, U.S.-U.K., S. Exec. Doc. Q, 96th Cong., 1st Sess. 5 (1979) 5

MISCELLANEOUS:

3 British Tax Review 148 (1977) 6

William C. Gifford, Permanent Establish Under the Nondiscrimination Clause in Income Tax Treaties, ii Cornell Int'l L.J. 51 (1978) 8

OECD Committee Report on Fiscal Affairs, *Model Double Taxation Convention on Income and on Capital* (1977) 4, 7

Klaus Vogel et al., *Klaus Vogel on Double Taxation Conventions* (1991) 7

No. 93-1132

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

REUTERS LIMITED,

Petitioner,

- vs. -

TAX APPEALS TRIBUNAL and
COMMISSIONER OF TAXATION AND FINANCE,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE
COURT OF APPEALS OF THE STATE OF NEW YORK

REPLY BRIEF FOR PETITIONER

Reuters Limited ("Reuters"), a United Kingdom company, respectfully submits this reply brief in further support of its petition for a writ of certiorari to review the judgment of the Court of Appeals of the State of New York.

The Respondents' brief in opposition ("Resp. Br.") so mischaracterizes the arguments raised in Reuters[1] petition that it fundamentally fails to address the issues actually before this Court. To the extent that it does address issues actually raised by Reuters, it improperly relies on speculation about events that have never been part of the record and on distortion beyond recognition of text, cases, and commentary. At bottom, respondents are unable to cite any textual interpretation, judicial authority (other than the opinions

[1] As a matter of style, Reuters does not use the possessive form — Reuters'— even where convention would use that form.

below), or scholarly opinion that supports the Court of Appeals' interpretation of the nondiscrimination clause of the *U.S.-U.K. Tax* Treaty. The holding below merits this Court's review because it threatens to disrupt the orderly administration of international tax law.

REASONS FOR GRANTING THE PETITION

I. THE DECISION BELOW IS CONTRARY TO THE TREATY'S LANGUAGE, ITS INTERPRETATION BY THE PARTIES, AND THE INTERPRETATION OF IDENTICAL TREATY LANGUAGE

A. The State's fundamental mischaracterization is that Reuters challenges the *per se* validity of the formula apportionment method of taxation used by New York and by other states to tax the income of foreign corporations. *See* Resp. Br. at 12. Reuters, however, has *never* argued that the New York method of taxation is *per se* invalid under the Treaty. *See* Petition for a Writ of Certiorari ("Pet.") at 3 n.3.[2] What the permanent establishment nondiscrimination clause of the Treaty *does* prohibit is the State placing a greater tax burden on Reuters New York branch activities — its permanent establishment — than the State places on a local company engaged in the same activities as Reuters permanent establishment. The clause does not limit the *method* or *means* of taxation; it does limit the amount of the tax *burden*. It is only the *application* of the formula apportionment method of taxation to Reuters for the years in question that is in issue.

When Reuters New York branch — which lost money for the years in question — is viewed properly as a separate entity for the purpose of measuring discrimination under Article 24(2), Reuters is clearly subjected to a greater tax burden than a local competitor. No domestic company engaged in the same activities as Reuters New York branch that lost money would be required to pay income tax under these circumstances. *See* Pet. at 15.

---

[2] As Reuters stated in its opening brief, "the *method* of taxation does not figure into the analysis of discrimination under Article 24(2)"; rather it is only the *total tax burden* that is in issue. Pet. at 20-21 (emphasis in original).

Because the State focuses on the *per se* validity of its method of taxation — not the discriminatory effect of the tax as it applies to Reuters — it both misses the point of the permanent establishment nondiscrimination clause and rarely addresses the issues in this case. Worse, the State uses its mischaracterization of Reuters position to raise the alarm that a ruling for Reuters would invalidate the method by which many states calculate corporate income tax. Resp. Br. at 12-13. Because Reuters does not challenge New York's method of taxing foreign corporations in general, the State's hyperbole is incorrect.[3]

The State — like the Court of Appeals — commences its argument by departing from the text of the Treaty. Thus, whereas Article 24(2) of the Treaty refers to "[t]he taxation on a permanent establishment," the State and the court below argue that the drafters must have meant taxation on the *enterprise*, of which the permanent establishment (branch) is a part. Resp. Br. at 10; Appendix to the Petition ("Pet. App."), 5a-6a. Presumably, if the Treaty meant to say that, it would have. The State's own argument, divorced from the language of the Treaty, reveals that the Treaty means something different than the State claims. As Reuters has explained, the language "taxation on a permanent establishment" requires treating the permanent establishment as a *separate entity* from the enterprise of which it is a part, and comparing the tax burden on the permanent establishment with "enterprises of that other State carrying on the same activities" as the permanent establishment. Treaty, Art. 24(2); Pet. at 11-15.[4]

There is simply no textual support for the State's position, adopted by the court below, that "the comparison required by the

---

[3] As Reuters has stated throughout these proceedings, New York taxes some foreign corporations on the basis of formulary apportionment and others, including foreign banks, by the separate accounting method of income determination. *See* Brief of Reuters in the Court of Appeals, at 44-46. New York, however, has refused to allow Reuters to use the separate accounting method for years in which the formula apportionment method produces a discriminatory result.

[4] Thus, the State's discourse on the meaning of "enterprises," "residents," and "corporations," Resp. Br. at 10-11, is simply irrelevant for purposes of Article 24(2), which is concerned with "taxation on a permanent establishment."

nondiscrimination clause is between a United States corporation with a branch office in New York, viewed as a single business enterprise, and a British corporation with a branch office in New York, also regarded as a single enterprise." Resp. Br. at 11; Pet. App. 7a. This focus on the nationality of the taxpayer is improper. Indeed, the OECD Commentary expressly states that the purpose of the Treaty's non-discrimination clause is "to end . . . discrimination based *not upon nationality but on the actual situs of the enterprise*." OECD Committee Report on Fiscal Affairs, *Model Double Taxation Convention on Income and on Capital* ("OECD Report") 165 (1977)[5] (emphasis added); Pet. 11-14.

Quite simply, the local permanent establishment (branch) of a foreign corporation cannot compete in a local market with a local company if its costs of doing business are inflated by a tax burden in excess of that placed on its local competitor competing in the same market. Accordingly, the test for discrimination is to look at the tax burden created by the activities of the branch and to compare it to the tax burden created by the activities of a hypothetical local company engaged in the same activities as the branch; if the tax burden is greater, then the Treaty has been violated.

The focus of the State and the court below on the fact that a branch is not a separate taxable entity misses the point of the nondiscrimination clause. Resp. Br. at 10-11; Pet. App. 5a-6a. That clause asks whether Reuters cost of doing business in the local market is being inflated by the State, not what legal entity actually pays the tax. To be sure, Reuters could have formed a New York subsidiary and avoided the discriminatory tax, Pet. App. 15a, but, as this Court has made clear, a state cannot "force a taxpayer to conduct its foreign business through a domestic subsidiary in order to avoid discriminatory taxation." *Kraft General Foods, Inc.* v.

---

[5] Elsewhere, the State cites to this Commentary and concedes that "the important factor is the situs of a corporation, not its nationality." Resp. Br. at 20. Although the State claims this is not "pertinent to the present case," *id.*, it is in fact directly contrary to the nationality-focused position taken by court below and the State throughout these proceedings. Contrary to the State's assertion, there is absolutely nothing misleading in Reuters quotation from the OECD Report, at 165. *See* Pet. at 14.

Iowa Dep't of Revenue and Finance, _ U.S. _, 112 S.Ct. 2365, 2369 (1992); Pet. at 15.

B. The State's extensive reliance on the legislative history to show that the Treaty does not prohibit states from taxing foreign nationals by applying the formula apportionment method of taxation to their worldwide income is simply irrelevant. Resp. Br. at 13-17. As Reuters acknowledges, the treaty permits any method of taxation, *so long as it does not discriminate in favor of local businesses.*

The State deals with the single most important piece of legislative history applicable to the actual issues in this case by pretending that it does not exist. As Reuters has noted, Pet. at 21, the Report of the Senate Foreign Relations Committee on the Treaty makes clear:

> Under the protocol, political subdivisions and local authorities of either country are free to use formula methods to apportion income, deductions and other items among related enterprises in determining income subject to their taxes, *so long as such methods do not violate the proposed treaty's nondiscrimination provisions.*

Third Protocol to the 1975 Income Tax Convention, as amended, U.S.-U.K., S. Exec. Doc. Q., 96th Cong., 1st Sess. 5 (1979) (emphasis added). Thus, the State's claim that "[t]here is absolutely no legislative history supporting petitioner's side of the argument," Resp. Br. at 16, is simply wrong.[6]

C. Unable to unearth a *single* domestic or foreign opinion or authority (other than the opinions below) to support its misinterpretation of Article 24(2), the State resorts to denigration and distortion of the authorities cited by Reuters. However, these authorities make clear that the Contracting States, foreign courts, and scholars have all taken the same position — discrimination under Article 24(2) is tested by looking at the permanent establishment as if it were a separate entity, and then determining

---

[6] As previously noted, Pet. at 21 n.18, reliance on Article 7(2) of the Treaty is misplaced because Reuters does not argue that Article 24(2) prohibits the formulary apportionment method *per se*. Resp. Br. at 17-18; Pet. App. 8a.

whether the permanent establishment is subject to any greater tax burden than a local competitor. Pet. at 15-20.

The U.S. Treasury Department, which negotiated the treaty on behalf of the United States, has adopted precisely the view advocated by Reuters here — in measuring discrimination under the Treaty, the permanent establishment of a foreign taxpayer must be viewed as a separate entity. I.R.S. Notice 89-80; Pet. at 16-17. Notice 89-80 expressly states that the excess interest tax on a *branch* does not violate Article 24(2) because, for purposes of Article 24(2), the foreign company's "branch is the functional equivalent . . . of a subsidiary." Notice 89-80, 1989-2 C.B. at 397; Pet. at 16. The State's attempt to distinguish the Notice is not only unavailing, it actually supports Reuters position. As the State is forced to acknowledge, the Notice requires that the branch be treated like a domestic subsidiary, Resp. Br. at 21-22, precisely the position Reuters advocates.

U.K. Inland Revenue, which negotiated the treaty on behalf of the United Kingdom, has taken the same view of the nondiscrimination comparison as U.S. Treasury. Pet. at 17. Because the State cannot argue with Inland Revenue's position, it attempts to discredit Reuters source material — the Inland Revenue letter submitted to the *British Tax Review*. Resp. Br. at 22.[7] The Inland Revenue letter refers to an *article* published in the *British Tax Review*. *See*, J. Oliver, *Discrimination*, 3 *British Tax Review* 148 (1977). The letter states that the test for discrimination was properly described on page 151 of the article, which stated that the non-discrimination comparison is made under Article 24(2) "by substituting for the United Kingdom *branch* of the non-resident (United States) corporation a United Kingdom *resident company* . . . ." *3 British Tax Review* at 151 (emphasis added). This is precisely the view advocated by Reuters here.

The State also cannot deny that the French court (the Conseil d'Etat), in *Judgment of November 18, 1985*, held that the proper basis for comparison in testing discrimination under a provision

---

[7] The Inland Revenue letter was sent to J.D.B. Oliver, an Editor of the *British Tax Review*, a leading expert on British taxation, and a partner at Coopers & Lybrand in London.

identical to Article 24(2) is to look at the permanent establishment as if it were a separate company. Resp. Br. at 23; Pet. at 18-19; Pet. App. 62a-64a. The State further concedes that "some nations" have adopted the French position. Resp. Br. at 23. The State then asserts — without citing a single example — that other nations have taken contrary views.[8] *Id.* The French decision is precisely on point, and the State has no contrary authority to refute it.

The State attempts to deal with the German Court decision cited by Reuters by confusing it beyond recognition. Resp. Br. at 24; Pet. at 19; Pet. App. 57a-61a. That decision is actually quite straightforward:

> A German capital tax is not payable on transfers of capital between branches of a German company.
>
> However, under German tax law a capital tax was payable on a transfer of capital between the German branch of a Japanese company and its parent.
>
> This tax did not violate the treaty because the German branch of the Japanese company is viewed as a separate entity for the purpose of measuring discrimination, and a separate German subsidiary would have had to pay the tax.

The German decision is in accord with the positions taken by Treasury, Inland Revenue, and the French Conseil d'Etat, in which the test for discrimination requires that the permanent establishment be treated as a separate entity, and that the tax burden arising out of its activities be compared to the tax burden on its *local* competitors.

The State is also unable to cite *any* scholarly writings to support its interpretation of Article 24(2). Both authorities cited by the State, Resp. Br. at 11, 19 — Klaus Vogel, the leading commentator on double taxation conventions, and William C. Gifford — have taken Reuters side. Klaus C. Vogel, *Klaus Vogel on Double Taxation*

---

[8] In fact, the OECD commentaries show that there is no division of opinion over the basis for comparison under the permanent establishment nondiscrimination clause; rather some countries differ only on the consequences of that comparison in the context of intra-company dividends. OECD Report, at 168.

Conventions at 132 (1991); William C. Gifford, *Permanent Establishments Under the Nondiscrimination Clause in Income Tax Treaties*, 11 Cornell Int'l. L.J. 51, 61 (1978) (Reuters position "is consistent with the purposes of the provision as stated in the 1977 commentary to the OECD Model Treaty, namely to end discrimination in the treatment of permanent establishments as compared with resident enterprises involved in similar operations"); Pet. at 19-20 n.17.

II. THE EXTRAORDINARY TAX COMPLIANCE BURDEN DISCRIMINATES AGAINST REUTERS IN VIOLATION OF THE TREATY AND THE FOREIGN COMMERCE CLAUSE

Respondent's brief is replete with unsubstantiated assertions that Reuters State tax filings for the previous sixty years must have conformed to New York's unique tax requirements, and therefore Reuters evidence of compliance and start-up costs is not credible. Resp. Br. at 5-7, 24-28. Yet the only *evidence* in the *record* on the burden of compliance is from Reuters, and that evidence shows the cost of compliance is, indeed, crushing. The State's argument is based exclusively on speculation about events *outside the record*, which says nothing about Reuters method of filing its returns from 1917 to 1976 or the burden of recasting Reuters worldwide accounts to conform to New York requirements during the earlier years of its presence in New York — years in which New York tax reporting had not yet reached its present level of complexity. Pet. at 22-23. Indeed, the only evidence in this case is that Reuters submitted *nonconforming* accounts in 1977, which the State chose to accept in the context of this case. Pet. at 6, 22.

The cost of providing *noncomplying* data is not in issue. The cost of providing *complying* data is. The uncontroverted record evidence shows that the burden on Reuters to maintain data in accordance with New York law in all of its operations around the world would be approximately $1,000,000 annually — and, indeed, would dwarf the tax. Pet. at 22-23. This case must be decided on the record, not on speculation and innuendo. *New Haven Inclusion Cases*, 399 U.S. 392, 450 n.66 (1970).

The State acknowledges that a similar compliance cost issue is before this Court in *Barclays Bank PLC v. Franchise Tax Board, cert. granted*, __ U.S. __, 114 S.Ct. 379 (1993), but relies solely on speculation about occurrences outside the record to argue that a ruling in *Barclay's* favor would be inapplicable to Reuters. The actual evidence in this case, however, demonstrates that the onerous compliance costs violate Article 24(2) and the Foreign Commerce Clause. Pet. at 21-23.

III. THE NEW YORK FRANCHISE TAX REGULATIONS FACIALLY DISCRIMINATE AGAINST FOREIGN SOURCE INCOME IN VIOLATION OF THE FOREIGN COMMERCE CLAUSE

The State completely misunderstands Reuters contention that New York's scheme is constitutionally infirm under *Kraft*, *supra*, because it discriminates against *foreign source income*. *Kraft*, 112 S.Ct. at 2368-70; Pet. at 23-25. Instead, the State's only response is that it does not impose different burdens on foreign and domestic *subsidiaries* — an observation completely irrelevant to whether the state taxes *income* differently depending upon whether it is from a foreign or domestic source. Resp. Br. at 28-29. The Foreign Commerce Clause issue raised by Reuters under *Kraft* challenges the way "entire net income" is computed under New York law by adding *foreign* source income, but not domestic source income, to federal taxable income (which is the starting point for New York taxation). Pet. at 24-25. Reuters does not challenge the facial validity of the formula apportionment method of taxation or disparate treatment of domestic and foreign subsidiaries, as the State mistakenly contends. New York law clearly discriminates against *foreign source income* in computing "entire net income." Pet. at 24-25. This discrimination is patently unconstitutional under *Kraft*. No showing of discrimination against foreign nationals is required under *Kraft*, which involved the taxation of the U.S. parent, not its foreign subsidiaries. *Kraft*, 112 S.Ct. at 2367, 2370-72. The constitutional violation arises solely from the discriminatory treatment of foreign source income, regardless whether the State is acting pursuant to a discriminatory motive or whether it taxes

foreign and domestic corporations differently.[9]

CONCLUSION

For the reasons stated herein and in the petition, the petition for a writ of certiorari should be granted.

Dated: February 23, 1994

Respectfully submitted,

Steven Alan Reiss
Counsel of Record
Philip T. Kaplan
David B. Goldstein
Weil, Gotshal & Manges
767 Fifth Avenue
New York, New York 10153
(212) 310-8000

Stuart H. Simon
Reuters America Inc.
1700 Broadway
New York, New York 10019
(212) 603-3300

Attorneys for Petitioner
Reuters Limited

---

[9] Although this Court stated that Iowa "imposes a burden on foreign subsidiaries that it does not impose on domestic subsidiaries," *Kraft*, 112 S.Ct. at 2371, the Foreign Commerce Clause violation in *Kraft* involved not a discriminatory taxation of foreign *subsidiaries*, but taxation of a domestic corporation that discriminated against foreign *commerce* by taxing certain foreign source income, but not identical domestic source income. *Id.* at 2370.